

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of')
HORACE C. AND MARY M. JENKINS)

For Appellants: Arthur G. Lawrence
Attorney at Law

For Respondent: John R. Akin
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Horace C. and Mary M. Jenkins against a proposed assessment of additional personal income tax in the amount of \$7,063.16 for the year 1972. Horace Jenkins and Mary Jenkins are husband and wife. Mary Jenkins is a party to this appeal only because the couple filed a joint income tax return. Consequently, Horace Jenkins will hereafter be referred to as appellant.

Appeal of Horace C. and Mary M. Jenkins

The sole question presented for decision is whether tax effect can be given to an oral agreement allocating all of a partnership's 1972 losses to appellant.

In 1971, appellant and three other individuals formed the JPL Properties partnership. The purpose of the partnership was to engage in the business of developing and leasing commercial and business properties. Two partners contributed a leasehold interest and were designated managing partners. Appellant and one other non-managing partner contributed \$50,000 each. A 25 percent capital contribution was credited to each partner's capital account. The partnership agreement provided that profits would be allocated in proportion to the capital accounts. No provision was made for allocation of losses.

In 1972, JPL Properties incurred a loss of \$94,175.35. The entire loss was allocated to appellant on the state partnership information return. On the federal partnership information return, however, the loss was allocated 68.35 percent to appellant and 31.65 percent to the other non-managing partner.

In 1973, appellant sold his interest in JPL Properties. In 1975, respondent audited appellant's 1972 return and disallowed the entire partnership loss. Following a protest, appellant's records were re-examined. At that time, appellant provided the auditor with a copy of a 1974 addendum to the partnership agreement. The addendum recited a special agreement among the partners which provided that appellant would receive 100 percent of the partnership tax deductions for 1972. The addendum stated that the special allocation was based on consideration of money loaned and financial guarantees made by appellant. This addendum was not part of appellant's books and records at the time of the initial audit in 1975. An undated letter from one of the managing partners purported to explain the addendum as a confirmation of an oral agreement the partners entered into in 1972. After due consideration of appellant's protest, respondent revised the proposed assessment to allow appellant 25 percent of the JPL Properties loss. This appeal results from respondent's disallowance of the remaining 75 percent of the loss.

Section 17855 of the Revenue and Taxation Code provides that a partner's distributive share of partnership income or loss is determined by the partnership

Appeal of Horace C. and Mary M. Jenkins

agreement. Section 17921, subdivision (c), of the Revenue and Taxation Code states that the partnership agreement includes any modification which is agreed to by all the partners and which is made prior to, or at, the time for filing the partnership return. The general right of the partners to determine allocations of profit or loss is limited by Revenue and Taxation Code section 17856. In 1972, the tax year in issue, section 17856 provided as follows:

A partner's distributive share of any item of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in subdivision (h) of Section 17852, for the taxable year, if--

(a) The partnership agreement does not provide as to the partner's distributive share of such item, or

(b) The principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this part.^{2/}

1/ Revenue and Taxation Code section 17856 was amended by Statutes 1977, chapter 1079, page 3291. The statute presently provides:

A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if--

(a) The partnership agreement does not provide as to the, partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or

(b) The allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not, have substantial economic effect.

Appeal of Horace C. and Mary M. Jenkins

Thus, under section 17856, a special allocation will not be given effect if the principal purpose of the allocation was the avoidance or evasion of income taxes.

Section 17856 was adopted by the California Legislature in 1955 soon after Congress added a substantially identical provision to the Internal Revenue Code. (Int. Rev. Code of 1954, § 704(b).) It is well settled in California that when state statutes are patterned after federal legislation on the same subject, the interpretation and effect given the federal provisions by the federal courts and administrative bodies are relevant in determining the proper construction of the California statutes. (Andrews v. Franchise Tax Board, 275 Cal.App.2d 653, 658 [80 Cal.Rptr. 403] (1969); Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).) Federal courts have decided that in order to determine whether a special allocation's principal purpose is for the avoidance or evasion of income tax, the provision must be considered in relation to all the surrounding facts and circumstances. A special allocation will be given effect only if it has business validity apart from its tax consequences. (Stanley C. Orrisch, 55 T.C. 395, 401 (1970), affd. per curiam, 31 Am.Fed.Tax R.2d 1069 (1973).) A determination by the Franchise Tax Board is presumptively correct, and the burden is on the taxpayer to prove that it is erroneous. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949).) -Thus, the burden is on appellant to show that the special allocation was adopted for business purposes rather than for tax avoidance.

Although appellant is represented by counsel, he did not submit a brief. The only indication of appellant's position is contained in a letter from appellant's attorney. The letter states that "Jenkins received all income (loss) for the calendar year 1972 because of economic considerations due to Jenkins' strong financial credit extended by him to the partnership to preserve its business in that year." In spite of repeated written requests by respondent for information concerning the specific date the partners orally agreed to the special allocation, and for information concerning the nature and extent of any loans and guarantees, appellant has submitted no further explanation or supporting documentation. We note, in addition, that appellant has failed to explain the inconsistency between the loss distribution taken on his state return and the loss distribution taken on his federal return. The record is insufficient to find that appellant has carried his burden to show

Appeal of Horace C. and Mary M. Jenkins

that the special allocation was adopted for business purposes rather than for tax avoidance. We therefore sustain respondent's **determination** that the partnership loss be allocated in accordance with Revenue and Taxation Code section 17856.

Appeal of Horace C. and Mary M. Jenkins

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section, 18595 of the Revenue and **Taxation** Code, that the action of the Franchise Tax Board on the protest of Horace C. and Mary M. Jenkins against a proposed assessme-nt of additional personal income tax in the amount of **\$7,063.16** for the year 1972, be and the same is hereby sustained.

Done at Sacramento, California, this; 5th day of April , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

<u>William M. Bennett</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Richard Nevins</u>	, Member
<u>Walter Harvey,*</u>	, Member

*For Kenneth Cory, 'per Government Code Section 7.9